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PRESIDENT AND CHIEF EXECUTIVE

May 9, 1997

The Honorable John D. Dingell
U.S. House of Representatives
Rayburn House Office Building, Room 2125
Washington, D.C. 20515-6115

Dear Congressman Dingell:

Thank you very much for your interest in the important issues surrounding the electric industry restructuring debate. I appreciate your allowing me the opportunity to comment on the questions in your letter of April 10. I hope these comments are helpful.

- 1. From your company's point of view, is it necessary for Congress to enact legislation bearing on retail competition, and why? If you favor legislation, please outline which issues should be addressed and how you think they should be resolved.**

The interstate commerce nature of the electric wholesale power market is clearly the purview of Congress. Congress enacted the Energy Policy Act in 1992, allowing more wholesale market access under the jurisdiction of the Federal Energy Regulatory Commission (FERC). Regulation of interstate commerce in the wholesale market is the appropriate role for the FERC. Traditionally, however, retail electric regulation has been a matter of state action and states have done a good job of regulating retail sales. It is not necessary, or appropriate, to have Congress preempt state action in an area which has traditionally been regulated by states.

Because any further restructuring of the electric industry would directly affect the retail market, states are in the best position to develop electric industry restructuring plans based on the local needs and concerns of electricity users in their state. Additionally, public policies that closely relate to electricity regulation (e.g. state environmental regulations, universal service requirements) are often closely related to the unique local needs and demands of each state.

Although some may argue that it would take individual states too long to implement retail competition, there are good reasons for a measured approach. The current system is not broken and retail competition involves significant uncertainties that affect a critical element of U.S. infrastructure. It is beneficial to all states to learn from those few states who have already decided that retail competition is necessary. Most states have not yet determined that retail competition is in their best interest at this time. With time, retail

competition may become more attractive for some states as more information is gathered through the experiences of others that have already adopted retail competition because of the unique circumstances that exist within those states.

Some would argue that Federal legislation is necessary to reconcile conflicts between the states, but it has not been demonstrated that the traditional Federal/State jurisdictional separation can't work. There is no significant demonstration that retail competition can't be offered on a state by state basis.

2. If the state(s) you serve has adopted or is considering adopting retail competition, what are your biggest concerns? Please be specific. Indicate how you are dealing with them and any recommendations you may have.

Recently, Texas and other states have adopted a more competitive wholesale market. The transition to wholesale competition is still taking place, and its full benefits have not yet been realized. Texas has not adopted retail competition. However, the Texas Legislature is currently considering proposals to adopt retail competition. There are many concerns to be considered and dealt with, including:

- * fairness to, and benefits for, all customers and customer classes*
- * recovery of all costs stranded by a change in public policy*
- * ensuring reliability of the transmission grid*
- * ensuring the maintenance of important infrastructure*
- * impact on the local and state tax system*
- * stranding of last resort customers*

3. Whether or not you favor federal legislation, please indicate your position on the following specific issues (to the extent not addressed in your prior responses):

- a. A Federal mandate requiring states to adopt retail competition by a date certain. If retail competition is under consideration in the state(s) you serve, do you believe Congress should provide additional direction or authority?**

There is no need for federal legislation at this time.

A Federal mandate requiring the states to adopt retail competition would not be in the best interests of most consumers. Texas has developed and maintained a reliable electric system with electric prices below the national average. If more change in the electric system is necessary, history shows that Texas can and will handle it best for Texans.

- b. Recovery of stranded investment. If the state(s) you serve already has adopted retail competition, how was this issue addressed and are you satisfied with the outcome? If your state(s) is considering adopting retail competition, how would you recommend that this issue be treated? Do you think Congress should enact legislation relating to stranded cost issues, and if so, what would you recommend? Is securitization a useful mechanism for dealing with stranded costs, and whom does it benefit?**

The Texas Legislature is considering, but has not adopted retail competition. Most participants in the restructuring debate seem to agree that full recovery of stranded costs is appropriate. If there is a change in public policy that has been in place for more than 80 years, then the costs of the change must be dealt with equitably. Utilities have made significant investments as a part of their legal obligation to serve all customers in their service areas in exchange for the right to recover such investments.

If Congress acts to mandate retail competition, full stranded cost recovery must also be mandated, and the FERC should be given the authority to ensure that this national policy is achieved. Any transition period to retail competition should be adequate so as to allow increased depreciation and cost savings to be applied to the balance of stranded costs. This methodology is preferred to securitization, but securitization may be necessary if the transition period is not adequate to fully recover transition costs. The credit enhancements of a properly structured securitization program can reduce the utility's capital costs and revenue requirements, resulting in benefits to both customers and utilities. With regards to the recovery mechanism, securitization should be combined with a non-bypassable wires charge, and utilities should have the ability to charge exit fees to large customers who attempt to bypass stranded cost charges. An exit fee mechanism will protect remaining customers and is consistent with the approach taken in FERC Order 888 for wholesale customers.

- c. Reciprocity. Can states condition access to their retail markets on the adoption of retail competition by other states? Should Congress enact such a requirement? Could such a requirement create an incentive for states with low electric rates not to adopt retail competition, in order to keep cheap power at home?**

That reciprocity is even an issue perhaps illustrates the fact that retail access may bring cost-shifting. That is, if retail access will bring about gains as claimed by its proponents (e.g., in efficiency), then each state would have reason itself to adopt retail access, regardless of reciprocity. Reciprocity requirements are an issue because retail access

may not be a "rising tide which raises all boats."

However, should Congress act, reciprocity is probably necessary to ensure that each states' customers receive any benefits that might be produced by that state's restructuring efforts. Notably, however, federal legislation regarding retail electricity service would indicate that such retail service is a matter of interstate commerce; consequently, reciprocity requirements could implicate the undue burden considerations contained in the Constitution's commerce clause.

- 4. If Congress enacts comprehensive restructuring legislation, should it mandate "unbundling" of local distribution company services? What effects would this have, and would they differ for various customer classes? Would this entail substantial expense, and who would incur any such costs?**

Even in the context of a retail access regime, it is not necessary for Congress to mandate the unbundling of distribution. There are substantial efficiencies in scope encompassed in the bundled "wires" segment of the business that would be lost if distribution was unbundled. If such efficiencies are lost, the increased costs will, in some form or fashion, be borne by customers. Which customers might most feel the burden is a function of the open market maxim that customers will pay "what the market will bear."

- 5. Recently Chair Moler of the Federal Energy Regulatory Commission recommended that, as part of comprehensive legislation, Congress authorize the Commission to enforce compliance with North American Electric Reliability Council standards to help maintain reliability of service. Do you believe this is necessary, and why or why not?**

The North American Electric Reliability Council (NERC) has been a self-help organization for more than 30 years, with an excellent record of voluntary member compliance with standards and protocols to ensure a reliable electric system. NERC is currently taking additional steps, consistent with a changing marketplace, to ensure electric system reliability.

Ongoing discussions in this effort are suggesting that FERC will have a "backstop" role and may or may not need its enforcement powers expanded through legislation. Commercial incentives and penalties for non-compliance are probably best, but it may be necessary in the long term to have Federal sanctions and backstop penalties for non-compliance. Federal action is not necessary now, although minimum Federal standards, much like New York Stock Exchange standards, may be appropriate. Since there is no crisis in electric reliability, it is more appropriate that Congress defer adopting

prescriptive regulations until it is clear that they will benefit, rather than hinder, the process.

- 6. What concerns does your company have with respect to the role of public power and federal power marketing agencies in an increasingly competitive wholesale electric market? In markets in which retail competition has been adopted? Are there concerns you would like to have addressed if Congress enacts comprehensive restructuring legislation? Should Congress consider changes to federal law as it applies to regulation of public or federal power's transmission obligations?**

If retail competition is implemented at either the state or federal levels, market participants that are subsidized by federal and state governments must be compelled to operate on the same level playing field as all other entities in the market. A competitive market should not include market participants who have an unfair advantage over other participants merely because they are governmental agencies.

- 7. If Congress enacts comprehensive restructuring legislation, should changes be made to federal, state or local tax codes, and if so, why? Please be specific.**

You may wish to note the following quote from an October 1996 study, "Federal, State and Local Tax Implications of Electric Industry Restructuring," that was performed by Deloitte & Touche for the National Council on Competition and the Electric Industry:

"Present state and local tax regimes for the electricity industry create essentially two policy issues in connection with electric utility competition. First, absent changes in the tax laws, competition is likely to reduce state and local tax revenue, as economic activity shifts away from the highly taxed regulated utility sector into less highly taxed sectors. Second, the present tax structure tends to treat different providers of electricity differently, so that when they start to compete with each other, the differing tax treatments will affect the competitive balance between them by reducing the costs of the more lightly taxed providers. These disparities could reduce or eliminate the economic benefits of competition, which depend on services being furnished by one or more low-cost providers and consumers being able to buy electricity at prices that reflect the cost of production."

As Congress studies comprehensive restructuring, it should consider implementing tax measures that will provide for suitable transition relief. The following specific issues should be considered by Congress as it contemplates restructuring the electric utility

industry:

1. *Restructuring Transactions*

Depending upon how public policy evolves regarding the industry, companies may be compelled to restructure their current operations. If traditionally integrated utilities are required to disaggregate into distinct operating organizations, tax impacts could be significant. Congress should seriously consider treating any mandated disaggregation or "unbundling" as a non-taxable event. This type of relief is not without precedent. There have been a number of instances (e.g., the banking industry, motor carrier industry, dispositions mandated by the FCC) in which specific provisions were added to federal law to accommodate certain tax-related hardships caused by new regulation.

Industry restructuring transactions could include the exchange of properties between companies instead of sale for cash. Current law allows for deferral of income tax, using a set of narrowly defined rules, if properties of "like kind" are exchanged. If the exchange of property between companies proves to be a necessary step to achieve public policy goals, Congress should consider broadening the like-kind exchange rules to include exchanges of generation, transmission and distribution property.

Congress should consider maintaining provisions such as non-abusive "Morris Trust" transactions to allow flexibility in spin-offs, mergers, and acquisitions. These types of transactions are sure to become more prevalent in the industry as increased size and diversification result in synergies.

2. *Nuclear Decommissioning*

Under current law utilities are allowed a current deduction (determined by a set of complex calculations) for nuclear decommissioning costs allocable to a qualified trust that are included in the utility's "cost of service." If cost-of-service regulation is abandoned and nuclear power plants are no longer included in the utility's cost of service, the current tax deduction could be zero. Thus, a revision to the existing tax rules may be required to maintain the tax incentive for pre-funding of nuclear decommissioning costs in a competitive marketplace.

3. *State and Local Taxes*

Existing state and local tax laws do not apply evenly among providers of electricity. Currently regulated providers face higher tax burdens than taxable nonregulated

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providers. Also, there are differences in tax treatment of taxable (i.e., utilities) and tax-exempt providers of electricity (i.e., cooperatives and municipally-owned utilities).

Currently the taxable regulated electricity providers pay special taxes which, under current law, would not apply to independent providers, cooperatives, or municipals. For example, in Texas this would include the state imposed gross receipt taxes and city franchise fees. In fact, cooperative and municipal providers have virtually no tax liability.

Tax differences directly affect costs to customers, and therefore, prices, under cost-of-service regulation. In contrast, if providers of electricity are competing with each other, higher taxed providers cannot necessarily pass their tax burden to their customers. An unintended consequence of such tax differences would be a shift in market share from more to less heavily taxed providers.

8. What, if any, concerns do you have about the reliability of the electric system? If the industry moved to retail competition, will adequate reserves be available? Is the transmission system capable of handling full retail competition?

Commercial pressures are in dynamic tension with reliability of the electric system. If the industry moves to retail competition, a distinction must be recognized between supply and demand balance (which the market will provide over time) and the instantaneous and continuous reliability of the grid that is vital for electric service. Public policy must recognize that all market participants are responsible for ensuring that electricity is continuously available to all customers. Because a move to retail competition would represent a significant departure from the historical approach to provision of electric utility service, time must be allowed for reliability standards and regulations to be formulated for any new market structure. In other words, reliability cannot be merely assumed -- it must be carefully planned and managed.

Hopefully this information will be helpful as the Commerce Committee considers the issue of electric industry restructuring. If I may ever be of assistance in any respect, please let me know.

Again, thank you for your interest and thoughtful consideration of these matters.

Sincerely,

